

Vermont Department of Taxes
TECHNICAL BULLETIN

TAX: INCOME

TB-05

SUBJECT: S CORPORATION, PARTNERSHIP AND
LIMITED LIABILITY COMPANY RETURNS;
ESTIMATED PAYMENTS OF INCOME
TAX BY THESE ENTITIES ON BEHALF OF
THEIR NONRESIDENT SHAREHOLDERS,
PARTNERS, AND MEMBERS

ISSUED: 01/21/97
REVISED: 11/09/06
09/26/08

A. GENERAL

S Corporations, Partnerships and Limited Liability Companies are not subject to tax on their income. They are subject to an annual entity tax as provided by Sections 32 V.S.A. §§5915 and 5921 and they must make estimated tax payments on behalf of their nonresident shareholders, partners or members.

B. ESTIMATED TAX PAYMENTS

Requirement: Effective for tax years beginning on or after January 1, 1997, every S Corporation, Partnership (other than a Publicly Traded Partnership¹), and Limited Liability Company that engages in business in Vermont must declare estimated tax and pay estimated tax, with respect to its **nonresident** shareholders, partners and members.

1. **Nonresident shareholder, partner or member** means any shareholder, partner or member who is not a Vermont resident, except any nonresident entity that is statutorily exempt in all circumstances from filing a Vermont income tax return, such as corporations specifically excluded from the corporate income tax pursuant to 32 V.S.A. §5811(3). This exclusion does not apply however, if income that is attributable to Vermont passes through the statutorily exempt entity to a shareholder, partner or member that is not exempt from Vermont income tax. S Corporations, Partnerships or Limited Liability Companies must make estimated payments for all nonresident shareholders, partners or members regardless of the amount of the shareholder, partner or member's pro rata share of income attributable to Vermont.

2. **Part year residents:** S Corporations, Partnerships or Limited Liability Companies shall be required to make estimated tax payments for part year residents on a pro rata basis proportional to the percentage of the year that the shareholder, partner or member was a

¹ Publicly Traded Partnerships defined in Section 7704(b) of the Internal Revenue Code and treated as partnerships for federal purposes under Section 7704(c) of same are not required to declare or pay estimated tax under the provisions of 32 V.S.A. §5920(c) provided they file an annual information return. The return shall include the name, address, tax identification number, and other information required by the department concerning each unit holder whose distributive share of partnership income, to the extent derived from or connected to sources in Vermont, as reflected on such annual return, is more than five hundred dollars.

nonresident. Payments made on behalf of part year residents need to be reported to the Tax Department so that the payments can be allocated properly.

3. **Estimated tax:** Effective May 3, 2005, the legislature amended Sections 5914(c) and 5920(c) to reflect prior changes to the manner in which Vermont personal income tax was calculated. “Estimated tax” was defined as an amount equal to the highest marginal tax rate in effect for individuals prescribed under Section 5822 of this title multiplied by the shareholder's pro rata share of the income attributable to Vermont.

Effective for tax years beginning on or after January 1, 2006, these sub-sections were further amended to lower that rate from the highest individual marginal rate (9.5 percent) to the **second lowest marginal rate (currently 7.2 percent)**.

4. **Income attributable to Vermont** includes all income that is required to be reported on the nonresident's Vermont K-1 and it is not limited to distributions made to the shareholders, partners or members. All the rules contained in subchapter 5 of Chapter 151, Title 32, regarding estimation of non-withheld income tax of individuals, apply to estimated payments by the above entities.

5. **Due date:** Estimated payments are due at the times specified for the making of estimated payments by an individual in subchapter 5 of Chapter 151 of Title 32. An individual is required to make estimated payments on the fifteenth day of the fourth, sixth, and ninth months of the tax year and the first month of the subsequent year (April 15, June 15, September 15, and January 15).

The Department interprets this provision to mean that the timing of estimated payments should reflect the tax year of the entity. Thus, an entity shall be required to make its estimated payments on the fifteenth day of the fourth, sixth, and ninth months of *its* tax year and the first month of the subsequent year. Thus, for example, an entity with a tax year ending June 30, 2006 would typically be required to make its estimated payments for that year on October 15, 2005, December 15, 2005, March 15, 2006, and July 15, 2006 with a “catch up” payment due September 15, 2006.

Note: See paragraph 8 below for special timing provisions for non-calendar year entities.

6. **Safe harbor calculation and “catch up payment”:** 32 V.S.A. §§ 5914 and 5920 require S Corporations, Partnerships and Limited Liability Companies to declare and pay estimated tax based on 100 percent of the income earned by its nonresident shareholders, partners or members attributable to Vermont. Because the estimated payments become due before an accurate determination can be made of the income earned by the entity in the taxable year, the Department established an administrative “safe harbor” procedure to simplify the calculation for estimated tax payments due on or after April 15, 2005.² This includes all

² The purpose of the safe harbor procedure is to establish a threshold which, if met, will permit a S Corporation, Partnership or Limited Liability Company to avoid the assessment of penalties and interest for the underpayment of the required estimated payments. An entity is not required to use the safe harbor procedure if it determines that the safe harbor will result in an overpayment of required estimated payments. However, failure to meet the safe harbor is done at the risk of the entity and the entity will be subject to any applicable penalties and interest as calculated on each separate estimated payment.

estimated tax payments due for tax years beginning on or after January 1, 2005. For estimated tax payments due on or after April 15, 2005, the following procedure may be used:

- a. For each of the four estimated tax payments that are due, compliance with the safe harbor shall require the S Corporation, Partnership or Limited Liability Company to make a payment of no less than one quarter of the total estimated tax payment that was required to be made for the immediately preceding tax year.³ These payments shall be made on the due dates as set forth above as established by the tax year of the entity.
- b. The S Corporation, Partnership or Limited Liability Company shall be required to make a fifth "catch up" payment equal to the total amount of estimated payments that is required to be made for the current tax year, less any sum paid in the four quarterly estimates. The catch up payment shall be due on or before the due date for filing the S Corporation, Partnership or Limited Liability Company return. This date shall not be extended notwithstanding any request for extension of the entity return.

SAFE HARBOR CALCULATION EXAMPLE

- a. S Corporation A is a calendar year entity.
- b. S Corporation A had \$200,000.00 income in 2006.
- c. S Corporation A had \$400,000.00 income in 2007.
- d. S Corporation A has one nonresident shareholder that owns 50% of the corporation.
- e. Total amount of estimated payments due for 2006 was \$7,200.00 (\$200,000.00 income multiplied by 50% nonresident ownership multiplied by marginal rate of 7.2%).
- f. Total amount of estimated payments due for 2007 is \$14,400.00 (\$400,000.00 income multiplied by 50% nonresident ownership multiplied by the next-to-lowest⁴ marginal rate of 7.2%)

Safe Harbor method

April 15, 2007:	\$ 1,800.00 due (\$7,200/4)
June 15, 2007:	\$ 1,800.00 due (\$7,200/4)
September 15, 2007:	\$ 1,800.00 due (\$7,200/4)
January 15, 2008:	\$ 1,800.00 due (\$7,200/4)
March 15, 2008:	<u>\$ 7,200.00</u> due (\$14,400.00 less \$7,200.00 paid in estimated payments)
<i>Total Paid</i>	\$14,400.00

³ There has been some confusion with regards to the effect of the rate change for 2006 on the amount of estimated payments that must be made under the safe harbor. The safe harbor amount due is based on the current rate; therefore each safe harbor payment would be one quarter of the prior year's income earned by its nonresident shareholders, partners or members attributable to Vermont multiplied by the current rate of 7.2%.

⁴ In 2005, No. 207 (Adj. Sess.), § 2, eff. May 31, 2006 "next-to-lowest marginal tax rate" replaced "highest marginal tax rate."

7. Special provisions for non-calendar year entities: A business entity required to make estimated payments may use a tax year different from a calendar year. In this case, its shareholders, partners or members report the income from that entity on the tax return for the year during which the business entity completed its tax year. For example, an individual shareholder of a business with a tax year ending June 30, 2006 would report the income from that business on his or her personal income tax returns for 2006.

A mismatched fiscal year creates an issue with respect to the application of estimated payments. Under the general rule, the Department applies estimated payments to match the way that income is reported on a shareholder, member or partner's tax return. Thus, in the example above, the estimated tax payments made by the entity with respect to its 2006 tax year would be credited to its shareholders during their 2006 tax year.

This application of payments can result in estimated payments being due long before the return of the shareholder, member or partner is due. Using the above example of an entity with a tax year ending June 30, 2006, the first estimated payment would be made on October 15, 2005, while the shareholder's 2006 tax return is not due until April of 2007.

To minimize the time between payment by the entity and the filing of the return by the shareholder, member or partner, the Department will permit a non-calendar year entity to delay the payment of all or part of certain quarterly estimates. Any quarterly estimate that would otherwise be due during a calendar year prior to the year on which it would be reported on an individual shareholder, member or partner's tax return may be deferred and included with the catch up payment due on or before the due date for filing the S Corporation, Partnership or Limited Liability Company return. This deferral of payment is specifically limited to that portion of the quarterly estimate that is attributable to individual shareholders, partners or members.

Using the example above, under the general rule, an entity with a tax year ending June 30, 2006 would be required to make estimated quarterly payments on October 15, 2006, December 15, 2006, March 15, 2007, and July 15, 2007, with a catch up payment due on or before September 15, 2007. Under this deferral provision, the entity would be permitted to defer the payment of the October and December 2006 payments until September 2007 provided that all of its nonresident shareholders are individuals.⁵ The March and July 2007 payments would not be deferred.

Any entity that elects to take advantage of this deferral provision shall be required to provide the Department with the information necessary to correctly allocate estimated payments.

8. Payments credited: The estimated tax payments made by the entity are considered to be a payment by the nonresident shareholder, partner, or member of the income tax imposed on the nonresident shareholder, partner or member. If the estimated tax payments exceed the nonresident shareholder's, partner's, or member's income tax liability as shown on their return for that year, such individual may be entitled to a refund of income tax. The entity is entitled to

⁵ In the event that an entity includes nonresident shareholders, partners or members that are not natural persons, the quarterly estimates that are due for prior calendar years are only deferred on a pro rata basis. There is no deferral of estimated payments for those payments allocated to non-natural shareholders, members or partners.

recover a payment from the nonresident shareholder, partner or member on whose behalf it was made. No shareholder, partner or member shall be entitled to claim a credit for any estimated tax payment unless and until:

- a. Such payment is received by the Vermont Department of Taxes; and
- b. The S Corporation, Partnership or Limited Liability Company has fully provided the required information set forth in paragraph C (3) below.

9. **Non-individual shareholders, partners and members:** Estimated tax payments must be made with respect to nonresident shareholders, partners and members that are not individuals in the same manner and at the same rate as required with respect to individual nonresident shareholders, partners and members (the second lowest rate set by section 5822 for individuals).

- a. If the nonresident is a taxable entity, such as a C Corporation, the estimated tax payment will be credited to it against its Vermont corporate income tax liability.
- b. If the nonresident is a pass-through entity, such as an S Corporation, Partnership or Limited liability Company, that entity must make estimated tax payments on behalf of its shareholders, partners or members. The estimated tax payments will be credited against the Vermont income tax liability of the shareholder, partner or member of such nonresident entity.
- c. If the nonresident shareholder, partner or member is an entity registered in a state other than Vermont and is registered with the Vermont Secretary of State as doing business in Vermont as a foreign entity, then that entity will not be subject to estimated tax payments if it has a principal headquarters or office located in Vermont. This interpretation shall be limited to the purposes of determining whether estimated tax payments are required and shall not be used for any other purpose.

C. **ENTITY RETURNS**

1. **Requirement:** Effective for tax years beginning on or after January 1, 1997, every S Corporation, Partnership and Limited Liability Company which engages in taxable activities in Vermont must file a return with the Commissioner of Taxes.

2. **Due date:** S Corporation returns, Partnership returns and Limited Liability Company returns are due on the date prescribed for filing under the Internal Revenue Code. For calendar year S Corporations, this date will generally be March 15. For calendar year Partnerships and Limited Liability Companies, this date will generally be April 15.

3. **Information required:** The return must include the name, address, the social security number or federal identification number of each shareholder, partner or member, the income attributable to Vermont and income not attributable to Vermont with respect to each shareholder, partner or member. A copy of the entity's federal return and all schedules must be attached to this return. This information must also be given to the shareholder, partner or member whom it concerns.

4. **Annual entity tax:** Every S Corporation, Partnership and Limited Liability Company must pay an annual tax at the rate specified by 32 V.S.A. §§ 5915 or 5921 at or before the time its return is originally required to be filed.

D. **COMPOSITE RETURNS**

1. **What is a composite return:** A composite return is a return filed by an entity on behalf of its eligible nonresident shareholders, partners or members stating the income allocable to each such shareholder, partner, or member. Composite returns relieve the included shareholders, partners or members from the responsibility of filing individual income tax returns.

Composite returns are allowed for the administrative convenience of both the Taxpayers and the Department. The election to file a composite return does not relieve an entity of the requirements to make estimated payments of income tax pursuant to 32 V.S.A. §§ 5914 or 5920. The composite filing shall be clearly indicated on all estimated payments that are made.

2. **Eligible nonresident shareholders, partners or members:** In order to be eligible⁶ for inclusion on a composite return, a nonresident shareholder, partner or member:

- a. Cannot have any income taxable to the State of Vermont other than that which is to be included in the composite return; and
- b. Cannot have income attributable to Vermont in excess of \$300,000.00.

3. **Who may file:** Any entity with an eligible nonresident shareholder, partner or member may elect composite filing by checking the box provided on Vermont Form WH435, Vermont Form WH-435SH, and Vermont Form BI-471. An election for composite filing shall be binding for a period of five years unless the election is revoked for failure to meet the requirements for composite filing. Such an election shall be made on or prior to the date that the first quarterly estimated payments of income tax pursuant to 32 V.S.A. §§ 5914 or 5920 for the tax year is due.

Every eligible nonresident shareholder, partner or member must be included in a composite filing unless the taxpayer has specifically applied for and received permission from the Department to exclude a specific eligible nonresident shareholder, partner or member.

In the event that an entity applies for and receives permission to exclude specific eligible nonresident shareholders, partners or members, such permission shall constitute an election to exclude such person for a period of not less than five years. All estimated payments made shall be attributed on a pro rata basis between all nonresident shareholders, partners or members.

⁶ In 2006, the Department amended the eligibility requirements for composite filing to delete the requirement that only natural persons can be included in a composite filing. The requirements set forth above are the only two eligibility requirements that must be met. These changes are effective for returns due on or after January 1, 2007.

4. **Existing composite filers:** Any entity which currently has received approval for composite filing by the Commissioner of Taxes and which meets the criteria for composite filing shall be automatically enrolled as a composite filer for a period of five years.

Existing composite filers shall be responsible for ensuring that future filings shall comply with all requirements of this Technical Bulletin. In the event that an existing composite filer wishes to exclude an eligible nonresident shareholder, partner or member from the composite filing, it must apply for permission to do so as set forth in subsection 3.

5. **Renewal of composite filing status:** After the expiration of the 5 year election period, an entity which continues to meet the criteria for composite filing shall be automatically renewed in the composite filing program on a year to year basis. Such an entity shall have a yearly option to notify the Department at least 90 days prior to the date the tax return is due, including extensions, that the entity has elected to opt out of composite filing, provided that an election to opt out shall terminate the entity's continued participation in the composite filing program for at least two years. To reenter the composite filing program after two years, the entity shall be required to make a new five year election as set forth above.

6. **Discretion to alter or deny composite filing:** Composite returns are not designed for tax avoidance purposes. Therefore the Department reserves the right to deny, alter or reject a composite filing when necessary to protect the tax revenues of the State of Vermont.

Specifically included within this discretion is the right to require the removal of one or more eligible nonresident shareholders, partners or members from a composite filing if the result of such composite filing is to reduce the liability of all eligible nonresident shareholder, partner or member's Vermont tax liability by \$5,000.00 or more.

In the event that the Department denies, alters or rejects a composite filing, the Taxpayer may petition the Commissioner for relief from the decision of the Department. Any relief granted shall be at the discretion of the Commissioner.

7. **Tax rate:** The composite filing tax rate is 8.5%.

In no event shall the pro rata composite tax attributable to a non-natural shareholder, partner or member be less than the minimum tax due that would otherwise have been due from that entity if it had not been relieved of a Vermont filing requirement because of its inclusion in the composite filing.

8. **Refunds:** To the extent that the tax due is less than the estimated tax payments made by the entity on behalf of its shareholders, partners, or members, refund shall be paid to the entity and not the individual shareholders, partners and members.

9. **Net operating, passive activity or capital losses:** The composite return shall reflect current year income only without deduction for any prior year loss.

10. **Other requirements:** A composite return must be verified by written declaration that the statements therein are made subject to the pains and penalties of perjury. Each qualified nonresident shareholder, partner or member must sign a power of attorney evidencing the authority of the S corporation, Partnership or Limited Liability Company to act on the

shareholder's, partner's or member's behalf and authorizing the Department to disclose confidential information to the S Corporation, Partnership, or Limited Liability Company as necessary to verify the returns. The S Corporation, Partnership or Limited Liability Company shall keep the signed powers of attorney on file and make them available to the Department upon request.

Molly Bachman
General Counsel

Date

Approved:

Tom Pelham
Commissioner of Taxes

Date